

## The Real Estate Process – Where does the money go?

Most people, especially first time home buyers or people selling their first home, have no real idea about how the real estate industry works. Many, in fact, have completely wrong ideas about the industry, especially as it concerns one of the most important aspects (to them anyway) – where the money goes. This explanation will look at the process from the two sides of the deal – the buyers' side and the sellers' side.

In order to provide a “context” for this explanation, we'll look at a very straightforward and fairly simple transaction. A homeowner has decided to sell his/her house. At the same time, a young couple has decided to buy their first house. Let's look at how those two parties might interact with the various real estate and other parties who could become involved in this sale.

The sellers decide that they don't want to try to market the property themselves so they call a local Realtor®. They may call more than one and conduct “interviews”, or they may have a reason to call one specific Realtor – recommendations from friends or family, as a response to the Realtor's advertising, whatever. Normally the realtor's first action might be to render a Comparative Market Analysis for the property and to advise the sellers in things that they might do to make the house more attractive to the market. The Realtor might also recommend an initial price or price range for the house, based upon the facts uncovered in the CMA process. The Realtor would also normally present some form of marketing plan for the property, outlining what he/she will be doing to market the property.



If the sellers are happy with the presentation of the Realtor and the CMA recommendations, they would proceed to list the house with him/her. Listing a house is essentially a contract between the homeowner and the broker that the agent works for to give that broker the exclusive right to market the property, in exchange for an agreed upon compensation – the commission.

From a Buyer's perspective, the first contact with a Realtor might come as a natural follow-up to some on-line research or perhaps from noticing a name and phone number on signs around town. In some cases Buyers might just call-in or walk-in to a local real estate office and request help with their home search. In many cases the Realtor might spend some time sending the Buyers listings that seem to meet their needs before they ever actually go visit a house. In any case some rapport building is required so that the Realtor can get a feel for what the Buyers are looking for in a new home.

A good agent will also introduce the Buyers to some lenders and suggest that they do the homework to get pre-qualified for a loan amount that likely would

cover the type of houses that they will be seeing. That process might help the Buyers establish a more realistic set of goals for their new home. So, that introduces the next player in the process – the mortgage broker or banker.

Now is a good time to introduce the concept of agency into the discussion. See the page on Agency at this site for a better explanation of the different types and duties. One key difference between the realtor and the other players in the home buying process is the concept of agency. The realtor is acting as a fiduciary agent for one side or the other in the process – representing either the sellers or the buyers. Other players in the process – mortgage brokers/banker, insurance agents, title agents, home inspectors and others, have no agency relationship with anyone in the process. They are acting for themselves, to make money out of the deal. That is not to say that the Realtor's involved will not make money, too; but their responsibilities to you as the Seller or Buyer have much deeper and more serious legal and moral definitions than anyone else in the deal. As a fiduciary, they are responsible for doing the right things to protect your interests. No other players have that responsibility.



**So, back to our example.**



The Sellers, after getting the CMA from an agent that they have chosen, decide to list with him and to put the house on the market for an asking price of \$210,000. The Listing agent is responsible for helping the Sellers' fill out all of the required paperwork to get the house listed. That paperwork will include a Seller's disclosure, in which the Sellers must accurately describe the condition of the property, to the best of their knowledge. There will also be disclosures concerning the presence of Lead-based paint in the house, again to the best of the knowledge of the current owners. There will be a listing contract of some sort – usually an Exclusive Right to Sell Contract – as well as a Multi-List Service (MLS) Data Sheet, which will list all of the pertinent information about the property that will be presented to the public by the MLS; and, an Agency Disclosure, signed by the Sellers and the Realtor, that defines the relationship with this particular Realtor as being their Seller's Agent. Other documents might include an owners' declaration about whether they own or rent a water softener, a document offering or declining to offer a home warranty and various other ancillary documents. Once all of these are complete the Realtor will enter the homes information into the MLS and begin marketing the property.

On the other side, the Buyers should be advised on the first or second meeting with the Realtor about Agency and given the state mandated booklet on agency to read. The Realtor should advise the Buyers immediately if they have called about seeing one of his/her listings that he/she is working for the Sellers, in that case, and that the Buyers should not divulge any confidential information to the Realtor until they establish some form of agency relationship with him/her. That does not mean that the Realtor is out to do anything to disadvantage the Buyers, but remember that he/she owes his/her fiduciary loyalty to the Sellers in that case. The Buyers could continue to work through the Sellers' agent or choose to go get an agent of their own. They may wish to engage the Realtor that they met through a call on one house as their Buyers' Agent for other houses.

On rare occasions, an agent who has a signed contract to represent a set of buyers may end up showing them a house that he/she has also listed. To do that, the agent must inform both the sellers and the buyers and get their written permission to act as a "dual agent". A dual agent cannot give full fiduciary loyalty to either side and must just provide an honest, neutral service to try to facilitate the process. Dual agents are sometimes referred to as transaction agents, since they are focused only upon facilitating the transaction and not working for either side. This is another cases where you need it in writing, no matter which side you were on.

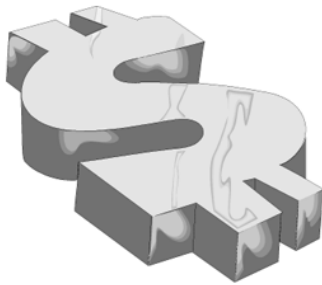
But, back to our simple example, with two different agents.

If the Buyers wish to have the Realtor work for them to look for houses, the realtor will ask them to sign an Exclusive Agency Contract, which defines the fiduciary responsibilities of the agent on the Buyer side and obligates the Buyers to the agent for some specific periods of time. Without a contract there is no agency and thus no fiduciary responsibility. The listing contract serves that purpose for the Sellers and the Exclusive Agency Contract serves that purpose with Buyers.



OK. So, now every party to the transaction is under some contract and has an agent representing them. Now comes the good part. The buyers, through their Buyer agent, make an offer to buy the house called a Purchase Agreement or sometimes an Offer to Purchase Real Estate. After some amount of negotiation, let's say that they buyers and seller settle upon \$200,000 as a fair price for the house and everyone signs the Purchase Agreement. We have a contract! It might have some contingencies that still must be satisfied prior to closing – an inspection, maybe a well and septic test, perhaps even the closing of the sale of the buyer's current home. Let's assume that we get through all of those and we have just closed the sale. Everyone is happy and all parties are leaving.

## SHOW ME THE MONEY!



So, where does all of that commission money go? The house sold for \$200,000 and the listing agent had specified a 6% commission. That's \$12,000 that goes in his/her pocket, right? Wrong!

First off, remember that there are two agents involved. Both want to get paid for their side of the deal. The normal split is 50-50, so \$6,000 is shipped to the Buy-side broker.

OK, that leaves our listing agent's Broker with \$6,000, too. How is that handled?

First of all, the broker normally splits the commission that an agent earns, taking a portion to cover the overhead costs of running the brokerage/office. The broker's part is anywhere from 40-60%, with 50% being a good figure to use. So that leaves \$3,000 for the agent, correct? Wrong, again!

The broker also takes out monies to cover things like the franchise fee, any extra office fees, such as color printing costs, and other driblets and drabs that normally add up to another 8-10% off the gross amount. Then the agent, if he/she has any financial discipline at all, will take out another 15-20% off the top to cover taxes and hold back 8-10% to cover advertising and marketing costs. So what does the agent end up with in his/her pocket at the end of all this? For all of that hard work marketing your home, or showing you homes, the agents each net about 32% of the original \$6,000 for that deal. In this case, that's about \$1,920. That's why they are so hard working. They have to sell a lot of homes to make a decent living.

And now, as Paul Harvey used to say, you know the rest of the story.